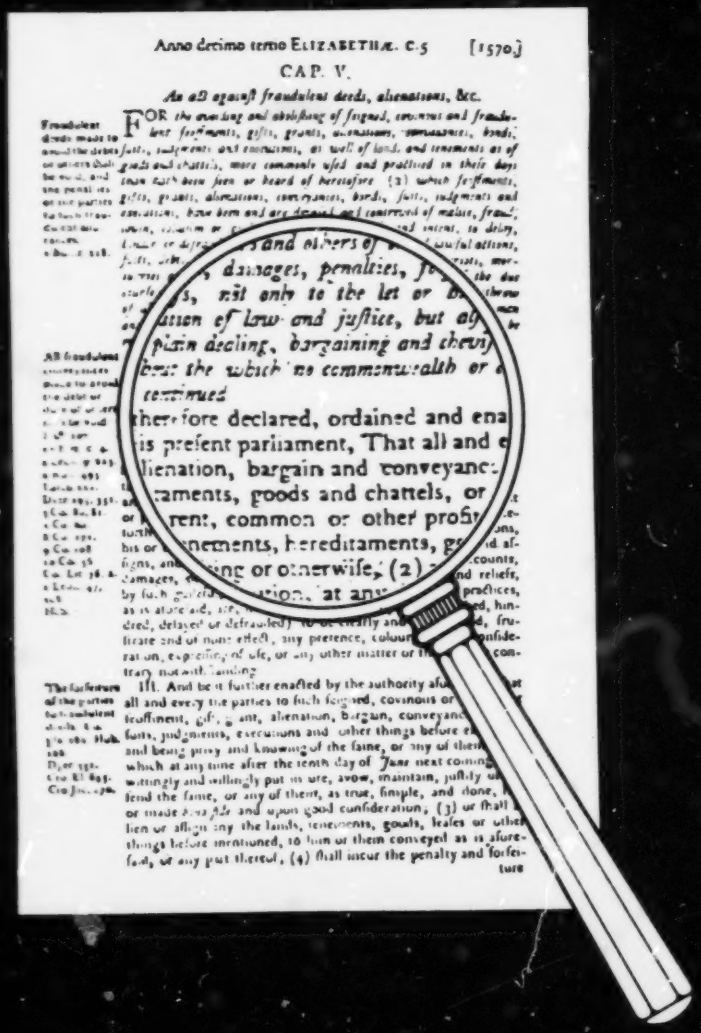
Law Reform Commission of Saskatchewan

Tentative Proposals for a Frustrated Contracts Act

Saskatchewan


Anno decimo tertio ELIZABETHÆ. C. 5 [1570]

CAP. V.

An act against fraudulent deeds, alienations, &c.

FOR the avoiding and abridging of fraud, covins and fraudulent feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments and executions, as well of lands and tenements as of goods and chattels, more commonly used and practised in these days than hath been seen or heard of heretofore (2) which feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments and executions, have been and are devised and contrived of malice, fraud, covin, collusion or guile, to the end, purpose and intent, to delay, hinder or defraud creditors and others of their just and lawful actions, suits, debts, accounts, damages, penalties, forfeitures, hindrances, molestations and disturbances, not only to the let or hindrance of the due course and execution of law and justice, but also to the overthrow of all true and plain dealing, bargaining and chevisance between man and man, without the which no commonwealth or society of people can continue

Fraudulent deeds made to avoid the debts of others shall be void, and the penal ac of the parties to such fraudulent deeds

All fraudulent conveyances made to avoid the debts or duties of others shall be void

The forfeiture of the parties to such fraudulent deeds &c.

Therefore declared, ordained and enacted by this present parliament, That all and every feoffment, gift, grant, alienation, bargain and conveyance of lands, tenements, goods and chattels, or any of them, or of any rent, common or other profit, commodity or hereditaments, hereditaments, goods and chattels, or any of them, by writing or otherwise, (2) and all bonds, suits, plaints, judgments, executions, counts, reckonings, sum and sums of money, accounts, damages, and reliefs, by such guileful means, practices, and devices as is aforesaid, shall be deemed, reputed and taken (only as against that person or persons, his heirs, successors, executors, administrators and assigns, whose actions, debts, accusations, duties, and other charges whatsoever, by such guileful means, practices, and devices as is aforesaid, shall be hindered, delayed or defrauded) to be clearly and utterly void, frustrate and of none effect, any pretence, colour, feigned consideration, expelling of use, or any other matter or thing to the contrary notwithstanding

III. And be it further enacted by the authority aforesaid, that all and every the parties to such feigned, covinous or fraudulent feoffment, gift, grant, alienation, bargain, conveyance, bond, suit, judgment, execution and other things before mentioned, and being privy and knowing of the same, or any of them, which at any time after the tenth day of June next coming, shall wittingly and willingly put in ure, avow, maintain, justify or defend the same, or any of them, as true, simple, and done, had or made bona fide and upon good consideration; (3) or shall alien or assign any the lands, tenements, goods, leases or other things before mentioned, to him or them conveyed as is aforesaid, or any part thereof, (4) shall incur the penalty and forfeiture

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Acknowledgement

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TENTATIVE PROPOSALS FOR A FRUSTRATED CONTRACTS ACT

Law Reform Commission of Saskatchewan

Saskatoon, Saskatchewan

April, 1987

The Law Reform Commission of Saskatchewan was established by An Act to Establish a Law Reform Commission, proclaimed in November, 1973, and began functioning in February of 1974.

The Commissioners are:

Professor Douglas A. Schmeiser, Q.C., B.A., LL.B., LL.M., S.J.D., Chairman
Madam Justice Marjorie A. Gerwing of the Saskatchewan Court of Appeal
Mr. Gordon J. Kuski, Q.C., LL.B.

Mr. Kenneth P.R. Hodges, B.A., LL.B. is Director of Research.

Mr. Michael J.W. Finley, B.A., M.A., LL.B. is the Legal Research Officer, and Mr. Roderick J. Wood, LL.B., LL.M., Dip. in Legislative Drafting, Mrs. Sandy Antonini-Ready, B.A., LL.B. and Mrs. Myra J. Bucsis, LL.B. are Legal Research Officers under contract. The secretaries are Mrs. Sandra Ritchie and Miss Pat Harasymchuk.

Professor Louis J. Romero and Mrs. Anne Skarsgard assisted in the background research for this project.

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The Law Reform Commission Act

6. The commission shall take and keep under review all the law of the province, including statute law, common law and judicial decisions, with a view to its systematic development and reform, including the codification, elimination of anomalies, repeal of obsolete and unnecessary enactments, reduction in the number of separate enactments and generally the simplification and modernization of the law.

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N o t e
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These proposals have been prepared by the research staff of the Commission and have been approved by the Commission for the purposes of discussion. A draft statute is included simply to indicate how the proposals might be implemented.

It is the policy of the Commission to seek response to its proposals before a final report is prepared for presentation to the Minister of Justice. Accordingly, the Commission invites comments and criticisms from the practising bar and others interested in this particular area of the law.

Submissions should be directed to:

Law Reform Commission of Saskatchewan
10th Floor, Sturdy-Stone Centre
122 Third Avenue North
SASKATOON, Saskatchewan
S7K 2H6

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I. INTRODUCTION

> The best laid schemes o' mice an' men
> Gang aft agley
> An' lea'e us nought but grief an' pain
> For promis'd joy.
>
> Robert Burns, To a Mouse.

A contract that seems quite sensible at the time it was entered into may be rendered unprofitable by unforeseen events. Dramatic increases in the costs of production or commodity prices may strip a businessman of his profits and force him to fulfil his contractual obligations at a substantial loss. For the most part the law holds the parties to their bargain. But occasionally the event is so unforeseen, or the contractual substratum has been so eroded by the event, that the law declares that the contract is at an end and discharges the parties from their unperformed future obligations. When this occurs the contract is said to be frustrated. War, government interference and expropriation are typical events sufficient to frustrate a contract.

Once a court decides that a contract is indeed frustrated, it is faced with another problem. The parties may have partially performed their obligations prior to the frustrating event. Money may have been paid over, and work may have been commenced and expenses incurred. It is here that the common law has been found to be lacking. The courts had only a very limited ability

to make adjustments that would permit the recovery of benefits conferred upon the other party to the contract. Legislation was passed in England to remedy this deficiency. Similar legislation has been enacted in all the common law provinces and territories except Saskatchewan and Nova Scotia.

The Commission proposes the adoption of an Act that would give the court a wide latitude to adjust the post-frustration situation in order to achieve a fair result.

II. THE DOCTRINE OF FRUSTRATION

1. Evolution of the doctrine

The early common law took a rigid view of contractual obligations. A party who by his own contract created a duty upon himself was absolutely bound to make it good. He could not complain that unforseen events rendered his performance futile or even impossible. It was thought that he could protect himself from such contingencies by express stipulation in the contract. This rule as to absolute contracts is said to be laid down in the seventeenth century case of Paradine v. Jane.[1] There, the court rejected the defendant's plea that he should not be responsible for unpaid rent by virtue of his being driven off the land by an invading army led by the German Prince Rupert.

There were three exceptions to this rule. The contract might be discharged by:

1. The death of a party where the undertaking was personal.[2]
2. Destruction of a chattel which was the specific subject matter of a contract of bailment.[3]

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[1] (1647), Aleyn 26, 82 E.R. 897.

[2] Dean and Chapter of Windsor v. Hyde (1601), 5 Co. Rep. 24(a), 77 E.R. 87.

[3] Williams v. Lloyd (1629), W. Jo. 179, 82 E.R. 95.

3. Illegality owing to the operation of a subsequent Act of Parliament.[4]

The whole basis for the modern doctrine of frustration is rooted in these three early exceptions.

The expansion of the doctrine of frustration began in earnest in 1863 with the case of Taylor v. Caldwell.[5] The plaintiffs rented a music hall from the defendants for the purpose of giving four concerts, but the hall accidently burned down before the first performance. Blackburn J. held that all parties were excused from performing their future obligations: the plaintiffs from paying the money for the music hall, and the defendants from performing their promise to give the use of the hall. Out of the first two exceptions he generalized the rule that if performance depends on the continued existence of a person or thing, impossibility of performance arising from the perishing of that person or thing will excuse performance.

Taylor v. Caldwell laid down the basis for a wider principle. Krell v. Henry[6] - one of the famous "Coronation Cases" - offers a classic example of it. The defendant agreed to rent a room from the plaintiff on the day Edward VII was to be

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[4] Brewster v. Kitchell (1698), 1 Salk. 198. This exception has since been extended to cases where performance is rendered illegal by exercise of government authority. See e.g., Bank Line, Ltd. v. Arthur Capel & Co., [1919] A.C. 435, [1918-19] All E.R. Rep. 504.

[5] (1863), 3 B. & S. 826, [1861-73] All E.R. Rep. 24.

[6] [1903] 2 K.B. 740, [1900-3] All E.R. Rep. 20.

crowned. Both parties understood that the rooms were rented to view the coronation procession, but this did not appear in the contract. The procession was postponed due to the illness of the King. The court found the contract to be frustrated. It did not think it essential that the direct subject of the contract should perish: "[i]t is sufficient if a state of things or condition expressed in the contract and essential to its performance perishes or fails to be in existence at that time".[7] Performance need not be impossible. It is enough that there be a fundamental change in the basis of the contract.

It seems that the legal theory underlying the doctrine of frustration has also evolved. Originally the doctrine was premised upon a theory of implied condition: in Taylor v. Caldwell the parties were found to have contracted on the basis of the continued existence of the music hall. This theory has been criticized, for "there is something of a logical difficulty in seeing how the parties could even impliedly have provided for something which, ex hypothesi, they neither expected or foresaw".[8] The view of Lord Wright is that the doctrine has been invented by courts to supplement the limitations of the actual contract:[9]

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7 Ibid., at 754 (K.B.), 26 (All E.R. Rep.).

8 Davis Contractors, Ltd. v. Fareham Urban District Council, [1956] 2 All E.R. 145, at 159, per Lord Radcliffe.

9 Fibrosa Spolka Akcyjna v. Fairburn Lawson Combe Barbour, Ltd., [1942] 2 All E.R. 122, at 140.

> That what is implied is what the court thinks the parties ought to have agreed on the basis of what is fair and reasonable, not what as individuals they would or might have agreed....The court is thus taken to assume the role of the reasonable man, and decides what the reasonable man would regard as just on the facts of the case. The hypothetical "reasonable man" is personified by the court itself. It is the court which decides.

Lord Radcliffe gives expression to the modern form of the doctrine:[10]

> ...frustration occurs whenever the law recognises that, without default of either party, a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. Non haec in foedera veni. It was not this that I promised to do.

Unfortunately, it is not easy to predict when the doctrine of frustration will be applied by the courts. A distinction is sometimes drawn between the object of the contract, which as its foundation will result in frustration of the contract should it become unattainable, and the motive of the parties which is not to be considered.[11] It is also said that a contract is not frustrated by a change of circumstances which merely affects the way in which a party has to carry out his obligations, even if

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[10] Davis Contractors, Ltd. v. Fareham Urban District Council, supra, footnote 8, at 160. This view was endorsed in Peter Kiewit Sons' Company of Canada Limited v. Eakins Construction Limited, [1960] S.C.R. 361, at 368.

[11] Herne Bay Steam Boat Co. v. Hutton, [1903] 2 K.B. 683, [1900-03] All E.R. Rep. 627. And see Cheshire & Fifoot, Law of Contract, (10th ed. M.P. Furston ed. 1981), at 517.

this makes performance more onerous.[12] In general, impossibility of performance (even if temporary)[13] offers a more secure basis for a finding of frustration than does a radical change of obligation where performance is still literally possible.

The courts have not been reluctant to impose limitations on the operation of the doctrine. A party cannot rely upon self-induced frustration.[14] The terms of the contract may indicate that the party was undertaking an absolute obligation to perform.[15] The court may conclude that the event was within the contemplation of one of the parties, and that he had tacitly accepted the risk of its occurrence.[16] But beyond this, a systematic analysis of the cases becomes difficult. Text-writers have devised several different classifications of frustrating events. But these groupings do not adequately explain the factors that are taken into account by the courts in invoking the doctrine.

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[12] Tsakiroglou & Co., Ltd. v. Noblee & Thorl G.m.b.H., [1962] A.C. 93, [1961] 2 All E.R. 179.

[13] Geipel v. Smith (1872), L.R. 7 Q.B. 404; Jackson v. Union Marine Insurance Co., Ltd. (1874), L.R. 10 C.P. 125.

[14] Maritime National Fish Ltd. v. Ocean Trawlers, Ltd., [1935] A.C. 524, [1935] All E.R. Rep. 86.

[15] Peter Cassidy Seed Co., Ltd. v. Osuustukkukauppa I.L., [1957] 1 All E.R. 484.

[16] Walton Harvey, Ltd. v. Walter and Homfrays, Ltd., [1931] 1 Ch. 274, [1930] All E.R. Rep. 465; Lane v. Lane, [1936] 1 D.L.R. 655 (Man. K.B.).

The most promising method of analysis is to view frustration as a risk-allocation procedure. The court must ultimately consider whether it is reasonable to place the risk of non-performance due to the supervening events upon one or the other of the parties. If the risk is placed upon a party, then he must perform or pay damages for breach of contract. If it is not reasonable to place the risk on either party the contract is frustrated. Professor Atiyah develops the following guidelines:[17]

1. A party may expressly agree to accept a certain risk in consideration of payment.

2. A party takes the risk of any changes in circumstances which affect only his own purposes in contracting, and do not affect the common object of both parties.

3. A party may enter into a contract whereby he receives a remuneration so abnormally large that it is only reasonable to place on him certain risks arising from the contract.

4. A person who undertakes to do something takes the risk that performance of his undertaking may prove more onerous than expected, or even impossible, as a result of changes in circumstances which are normal, whereas he does not take the risk of performance proving impossible owing to utterly abnormal or extraordinary occurrences.

5. Even though a person does not normally take the risk of non-performance where performance is rendered impossible as a result of utterly abnormal developments, the courts will place on him the risk of non-performance if the result of the impossibility is to give him a remedy against some other person.

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[17] An Introduction to the Law of Contract (3rd ed. 1981), at 211-15.

6. As a rough general rule, if parties make a contract which is only to be performed at some distant future date, one or other of them will be held to have assumed the risk of performance whatever the future may bring.

2. Reform of the doctrine

Some commentators have argued that the doctrine of frustration requires reform. Professor R.M. Goode states:[18]

> [T]he doctrine is too inflexible, for it involves an all-or-nothing approach. Ignoring cases where the frustrating event is temporary only, so that the contract is merely suspended and not terminated, the impact of a supervening disabling event is either that the contract is frustrated, in which it comes to an end, or that it is not, in which case its terms are enforceable in all their rigour. What is needed is some legal mechanism for adjusting contract terms so as to divide between the parties on a more equitable basis the cost of serious and unforeseen intervening events, leaving the contract to continue in force as adjusted.

The Uniform Sale of Goods Act adopted by the Uniform Law Conference of Canada[19] (and which was greatly influenced by Article 2 of the American Uniform Commercial Code) provides such a mechanism. It contains provisions for pro-rated performance[20] and substituted performance[21] upon frustration of a contract for the sale of goods.

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[18] R.M. Goode, Commercial Law (1982), at 137.

[19] Proceedings of the 63rd Annual Meeting (1981), at 185.

[20] Uniform Sale of Goods Act, s.8.13.

[21] Ibid., s.8.14.

The Uniform Sale of Goods Act,[22] Article 2 of the U.C.C.,[23] and the frustration sections of the American second Restatement of Contracts[24] also set out to restate the doctrine of frustration. These efforts have attracted some criticism on the ground that to do so might result in a rigid rule that might within a few years fail to meet the needs of society.[25] A more telling criticism is that the classification used adds little to the common law, and does not even mention the allocation of risk as a factor.

While these developments are of interest, the most pressing problem is not with the doctrine of frustration, but with the law of restitution that operates after a contract is found to be frustrated. As will be seen, the common law response is inadequate. A statutory solution is required.

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22 Ibid., s.8.11.

23 U.C.C. 2-615.

24 American Law Institute, Restatement of Contracts 2d (1981), ss.261-6.

25 Law Reform Commission of British Columbia, Report on Frustrated Contracts Legislation (1971), at 16-17; D. Mullan, Frustrated Contracts Law - A Study Paper (1976), Nova Scotia Law Reform Advisory Commission, at 14-15.

III. RESTITUTION OF BENEFITS CONFERRED UNDER FRUSTRATED CONTRACTS

1. Recovery under the common law

Frustration puts an end to the contract and discharges the parties from liability for future performance. But only future performance is excused. The contract remains a valid and subsisting contract up to the moment of frustration. The parties are not excused from performing obligations which have accrued prior to frustration.

Chandler v. Webster,[26] another of the "Coronation Cases", provides a useful example of this principle. A renter agreed to pay £141 15 s. for a room in Pall Mall for viewing the coronation procession. This sum was payable immediately, and in fact £100 had been paid. This left £41 15s. owing but unpaid as of June 24, 1902, at which date the contract was discharged by virtue of the procession's cancellation. Not only was the would-be renter unable to recover the £100, but he remained liable for the balance of £41 15 s. Yet if, as in Krell v. Henry,[27] the obligation to pay the balance did not mature until sometime after the cancellation of the procession, the obligation to pay would be discharged. The Court of Appeal in Chandler v. Webster held

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[26] [1904] 1 K.B. 493.

[27] Supra, footnote 6.

that a claim for the recovery of money on the ground of a total failure of consideration was not available where the contract was discharged through frustration.

Four decades later, in the Fibrosa case,[28] the House of Lords overruled the Chandler decision. An English company had agreed to sell and deliver machinery to be built by it to a Polish company in Gdynia. One- third of the purchase price was payable in advance. After pre-payment, but before construction of the machinery was completed, the Germans invaded Poland and Gdynia became enemy-occupied territory. This event extinguished the English company's obligation to deliver the machinery, since trading with the enemy would have been an illegal act. The Polish company asked for the return of its part-payment on the ground of total failure of consideration. The English company resisted, saying that considerable work had already been done on the machinery.

The House of Lords held that an action for recovery of money founded upon a total failure of consideration was available, and that the Polish company was entitled to the return of its money. The scope of the Fibrosa decision is limited. It applies only where there has been a total failure of consideration. The receipt of some benefit, no matter how small, will defeat the claim for the return of money. If in the Fibrosa case the English manufacturers had benefited the Polish buyers to some

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[28] Supra, footnote 9.

minor extent, such as sending them plans required under the contract, the Polish company's claim would be defeated. The Fibrosa decision may also work an injustice upon the person to whom the money is paid. Where there has been a total failure of consideration, he must repay the money notwithstanding that he has been put to considerable expense. Indeed, though he may have been on the verge of completion, he can get no compensation.

The Fibrosa decision only applied to an action to recover money. The common law constructed equally vexing hurdles where the claim was in respect of services rendered or property transferred before discharge of the contract through frustration. Recovery for the value of part-performance was made difficult by the common law rule of entire contracts, known also as the rule in Cutter v. Powell.[29] This holds that no payment for part performance can be claimed by a party to an entire contract. An entire contract has been defined by Glanville Williams as:[30]

> [a] contract in which it is agreed that complete performance shall be a condition precedent to recovery on the contract, or else a contract in which the consideration is a lump sum (or other entire consideration), and no provision is made for setting off a portion of this consideration against a portion of the performance.

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[29] (1795), 6 T.R. 320, 101 E.R. 573, [1775-1802] All E.R. Rep. 159.

[30] "Partial Performance of Entire Contracts, I" (1941), 27 L.Q.R. 373, at 373-74.

Cutter v. Powell was the case of a sailor who was employed as second mate on a voyage from Jamaica to Liverpool. Cutter was to be paid 30 guineas "ten days after the ship arrives at Liverpool...provided he proceeds, continues and does his duty...from hence to the port of Liverpool". Cutter died on the voyage, and his administratrix sued for the value of the work he had done before he died. The contract was construed to be entire, and Cutter's administratrix failed in her claim.

This rule was applied to a frustrated contract in Appleby v. Myers.[31] A supplier of machinery contracted to install certain machinery on the defendant's premises and to keep it in repair for two years. The price was to be paid on completion. After part of the work had been completed, an accidental fire broke out and completely destroyed the premises. The supplier sought to recover compensation for work done and materials supplied before frustration. His claim was rejected. Blackburn J. held that the contract was entire. Full performance would have to be rendered before the plaintiff could claim the price.

Glanville Williams has denounced this rule as arbitrary.[32] He makes the point that when parties contract for the performance of an entire work for a specific sum all that can be said for certain is that they did not intend the full sum to be paid

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[31] (1867), L.R. 2 C.P. 651, [1861-73] All E.R. Rep. 452.

[32] Supra, footnote 30, at 392-93. See also S.J. Stoljar, "The Great Case of Cutter v. Powell" (1956), 34 Can. Bar Rev. 288.

unless the contract is fully performed. It does not follow that it was their intention that nothing should be paid unless the work is completed. Therefore, a first criticism of the rule of entire contracts is that too often the courts have been willing to conclude from the fact that payment is to be made upon performance that the parties also agreed that there should be no payment if full performance is not rendered.

The common law invented yet another barrier to the recovery for part performance in the case of an entire contract. Notwithstanding that the rule in Cutter v. Powell blocked a claim to compensation under the law of contract, a claimant might still make a claim for recompense under the law of restitution. The restitutionary claim for recovery of the value of services rendered is an action upon a quantum meruit. The claimant under a frustrated contract faces a difficulty: quantum meruit was originally based upon a theory of implied contract. If there is an express contract between the parties, it is impossible to imply another contract with conflicting terms.[33]

This obstacle has almost certainly been circumvented by the decision of the Supreme Court of Canada in Deglman v. Guaranty Trust Company of Canada.[34] The claimant sought to recover from the estate of his deceased aunt under an oral agreement under which he was to perform such services as she might request and

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[33] Britain v. Rossiter (1879), 11 Q.B.D. 123.

[34] [1954] S.C.R. 725.

she was to leave him a certain piece of land in her will. The claimant's aunt died intestate, and the oral contract was held to be unenforceable because it violated the Statute of Frauds. The Supreme Court of Canada allowed the claimant to recover the fair value of the services rendered by him. The Court rejected the implied contract theory as the theoretical basis of restitutionary relief, and adopted the following passages of Lord Wright from the Fibrosa case:[35]

> It is clear that any civilized system of law is bound to provide remedies for cases of what has been called unjust enrichment or unjust benefit, that is to prevent a man from retaining the money of or some benefit derived from another which it is against conscience that he should keep. Such remedies in English law are generically different from remedies in contract or in tort, and are now recognized to fall within a third category of the common law which has been called quasi-contract or restitution.

and further:

> Lord Mansfield does not say that the law implies a promise. The law implies a debt or obligation which is a different thing. In fact, he denies that there is a contract; the obligation is as efficacious as if it were upon a contract. The obligation is a creation of the law, just as much as an obligation in tort. The obligation belongs to a third class, distinct from either contract or tort though it resembles contract rather than tort.

Admittedly, the Supreme Court of Canada dealt with this principle in a different context, for it was considering an unenforceable contract rather than one discharged through frustration. Nevertheless, it is widely enough stated to overcome the

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[35] Ibid., at 734, quoting from [1943] A.C. 32, at 61-2.

objection that there can be no compensation for partial performance because the implied contract would contradict the express one.

Indeed, the Deglman decision may have a wider effect. It might now be argued that the Court's adoption of the principle of unjust enrichment as the basis of a claimant's restitutionary claim compels a modification of the rule that the recovery of money can only take place when the consideration has totally failed. The Supreme Court of Canada on several occasions since Deglman has recognized the principle of unjust enrichment as the basis of the right to restitution.[36] The courts may now proceed to develop the restitutionary remedies in light of the new principle, rather than being forever bound by the peculiar dictates of the old forms of action.[37] To put it simply, a rule that bars recovery except in the case of a total failure of consideration leads to unjust enrichment and contradicts the principle upon which the remedy is now founded.

2. The need for reform

The difficulties with the traditional common law stem from the following rules:

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[36] Carelton v. Ottawa, [1965] S.C.R. 663; Storthoaks v. Mobil Oil Canada, Ltd., [1976] 2 S.C.R. 147; Pettkus v. Becker, [1980] 2 S.C.R. 834; Sorochan v. Sorochan (1986), 29 D.L.R. (4th) 1.

[37] See also G.B. Klippert, Unjust Enrichment (1983), at 38-42 and 48-51; G.H.L. Fridman and J.G. McLeod, Restitution (1982), at 17-19.

1. Contractual obligations accrued before frustration remain enforceable.

2. Money paid or payable is not recoverable unless there has been a total failure of consideration.

3. There is no recompense for work or services unless the contract can be regarded as severable, and the severable portion has been fully performed.

4. There is no redress for a party who has incurred expenses for the purpose of performing the contract.

The Deglman decision likely remedies the third matter and permits recovery for services rendered under a frustrated contract on a quantum meruit. It may also be argued that the decision suggests an extension of restitutionary relief for the recovery of money where there has been a partial failure of consideration. This would, however, require a major reworking of the restitutionary remedies.

Deglman opens the way for a reshaping of the law of restitution in frustration cases, but to date that step has not been taken. It has been more than thirty years since Deglman was decided, yet there has been no instance where restitutionary principles were applied to grant recovery under a frustrated contract. And since every common law province except Saskatchewan and Nova Scotia now possess frustrated contracts legislation, the development of such principles can be expected to be sporadic at best. Furthermore, there are numerous questions concerning restitutionary principles that have yet to be answered. For example, it is unclear whether the benefit is

to be measured by the value of the work done, or whether it is to be measured by the extent to which the other party has been enriched.[38] This becomes important when the frustrating event destroys the performance (as in Appleby v. Myers, where a supplier installed some of the machinery on the owner's land before the premises were destroyed by fire). And even if such a restitutionary approach were to be consistently followed in the future, it would be no panacea in frustration cases. A restitutionary claim does not compensate a plaintiff for a loss; instead, it strips the defendant of a benefit that he has unjustly gained at the plaintiff's expense. There remains the problem of a party who has incurred expenses in preparation of contractual performance (as in the case of the English machinery manufacturers in Fibrosa).

The Commission is of the view that a legislative solution is required to provide a fair system of apportionment when contracts have been prematurely brought to an end by the application of the common law doctrine of frustration.

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[38] Academic opinion favours the view that restitution should be made for the services performed rather than for the ultimate benefit. See Woodward, Quasi-contracts (1913), at 182-84; Goff and Jones, The Law of Restitution (2nd ed. 1978), at 564-5. Goff and Jones admit that this view has not yet been recognized in English law.

IV. LEGISLATIVE REFORM IN OTHER JURISDICTIONS

1. Overview

In 1943 the British Parliament passed the Law Reform (Frustrated Contracts) Act, 1943.[39] Similar legislation was enacted by New Zealand[40] and the Australian State of Victoria.[41] In 1948 the Conference of Commissioners on Uniformity in Canada adopted a Uniform Frustrated Contracts Act, which was substantially the same as the English Act.[42] This uniform act was enacted by every common law province[43] with the exception of British Columbia, Saskatchewan and Nova Scotia, and will be briefly examined in the next section.

In 1971 the Law Reform Commission of British Columbia published its Report on the Need for Frustrated Contracts Legislation.[44] The report recommended the adoption of a new act which would remedy many of the problems with the English and

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39 6 & 7 Geo. 6, c.40 (U.K.).

40 Frustrated Contracts Act, 1944, N.Z.S. 1944, No. 20 (N.Z.).

41 Frustrated Contracts Act, 1959, No. 6539 (Vict.).

42 1948 Conference Proceedings, at 18.

43 S.A. 1949, c.44, now R.S.A. 1980, c.F-20; S.M. 1949, c.21, now R.S.M. 1970, c.F-190; S.N.B. 1949, c.19, now R.S.N.B. 1973, c.F-24; S.O. 1949, c.36, now R.S.O. 1980, c.179; S.P.E.I. 1949, c.15; now R.S.P.E.I. 1974, c.F-14; S.Nfld. 1956, No.29, now R.S.Nfld. 1970, c.144; O.N.W.T. 1956 (2nd), c.1, now R.S.N.W.T. 1970, c.F-10; O.Y.T. 1956, c.1, now R.O.Y.T. 1971, c.F-10.

44 (1971), L.R.C. 3 (hereafter the "British Columbia Report").

(old) Uniform Act. In 1973 the Uniform Law Conference adopted a new Uniform Frustrated Contracts Act[45] based on the British Columbia Report. In 1974 British Columbia enacted this legislation.[46] In 1976 the Nova Scotia Law Reform Advisory Commission published a study paper prepared by Professor David Mullan.[47] The paper recommended that Nova Scotia enact legislation along the lines of the British Columbia Act, but with a few changes and clarifications.

The Law Reform Commission of New South Wales published its Report on Frustrated Contacts[48] in 1976. Although the Commission did not disagree with the approach taken in the British Columbia report, the draft statute it proposed was very different from the British Columbia Act. In 1978 the New South Wales Parliament enacted the statute.[49] In 1983 the Law Reform Committee of South Australia[50] issued a report endorsing the principles underlying the British Columbia Act. Although it had originally proposed

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45 1973 Conference Proceedings, at 323.

46 Frustrated Contracts Act, S.B.C. 1974, c.37, now R.S.B.C. 1979, c.144.

47 Frustrated Contracts Law - A Study Paper (1976).

48 (1976), L.R.C. 25 (hereafter the "New South Wales Report").

49 Frustrated Contracts Act, 1978, S.N.S.W. 1978, No. 105.

50 Seventy-First Report of the Law Reform Committee of South Australia Relating to the Doctrine of Frustration of the Law of Contract (1983).

the adoption of the English Act in the interests of uniformity,[51] the Committee thought that this was no longer a constraining factor in light of New South Wales' refusal to cast its statute in the mould of the English Act.

2. The Old Uniform Act

The old Uniform Act applied when, prior to frustration, sums were paid or payable, or some other valuable benefit was obtained as a result of anything done in performance of the contract. The basic scheme of the Act is as follows:

1. Money paid or payable prior to frustration is recoverable,[52] but the court has the discretion to permit an offset for incurred expenses "if it considers it just to do so having regard to all the circumstances".[53]

2. If a valuable benefit (other than money) is obtained by a party by reason of anything done by the other party in connection with the performance of the contract, the court may order that all or part of it be recovered if it considers it just to do so.[54]

Certain classes of contracts are excluded from the operation of the statute.[55]

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[51] Thirty-Seventh Report of the Law Reform Committee of South Australia (1974).

[52] Section 4(1)(a).

[53] Section 4(2).

[54] Section 4(3).

[55] Excluded are charter parties and contracts for the carriage of goods by sea, contracts of insurance, and contracts for the sale of goods which perish at the time the contract is made or before the risk passes to the buyer.

Goff and Jones regard the offset provision as one of the most controversial parts of the Act. Where there is a prepayment, the party to whom the money is paid cannot recover any of his expenses in excess of the pre-payment. This was based on the assumption that in stipulating for prepayment the payee always intends to protect himself against loss under the contract. Goff and Jones question this assumption:[56]

> It by no means follows that, where a prepayment is stipulated for, the parties intend that the payer shall stand the risk of expenditure lost by the payee because of the frustration of the contract. The object of the advance may be to put the payee in funds to continue the contract, or to protect him from loss flowing from the payer's breach or insolvency.

The right to recover the value of a benefit (other than money) obtained by the other party is limited. The "benefit" is measured by the actual advantage received by the party after the frustrating event. If a party has received no real benefit from the partial performance, he does not have to pay for it and the full loss is borne by the other party. The Act therefore does not relieve the hardship in a case such as Appleby v. Myers, in which the supplier of machinery was denied recovery for his work done before the premises were destroyed by fire,[57] since it lacks a system for apportioning the loss between the parties in such cases. The Act has also been criticised because of its use of

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[56] The Law of Restitution (2nd ed. 1978), at 567.

[57] Parsons Bros. Ltd. v. Shea (1965), 53 D.L.R. (2d) 86 (Nfld.S.C.); B.P. Exploration Co. (Lybia) Ltd. v. Hunt (No.2), [1982] 1 All E.R. 925.

discretion. It is said that in commercial contracts it is undesirable that these questions should depend on the uncertain exercise of judicial discretion.[58]

3. The British Columbia Act

The Report of the Law Reform Commission of British Columbia, having examined some of the short-comings of the old Uniform Act, sought a new approach. Reference was made to the work of Goff and Jones:[59]

> There are two other solutions which might have been adopted. One is that, whereas benefits received by either party in pursuance of the contract should be restored or paid for, the loss of expenditure otherwise incurred under the contract should lie where it falls. This is the solution generally adopted in the United States. The other solution is that, in addition to restitution of benefits received, the two parties should bear equally the expenditure otherwise incurred by both under the contract. This solution regards the contract as a joint adventure which has failed without fault. The choice is not easy, but we suggest that the former of the two solutions should have been adopted by Parliament as being more in accordance with business ethics and commercial expectations.

The difference between the two solutions can be illustrated by applying each to the facts in Fibrosa. Under the approach favoured by Goff and Jones, the full loss would be placed on the manufacturer of the equipment who would have to absorb the expenses incurred in its part-performance. The other solution

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[58] The Law of Restitution (1st ed. 1966), at 333.

[59] British Columbia Report, at 31, quoting from The Law of Restitution, ibid., at 333.

would be to apportion the expenditures incurred equally between the parties. Thus each party would bear half the cost of the supplier's part-performance.

The apportionment solution was favoured by Glanville Williams, who commented:[60]

> The situation with which the [English] Act is concerned is the familiar one in which one of two parties has to suffer loss for which neither is responsible. In my submission, natural justice does not indicate either of such parties as the one to bear the whole of the loss. Natural justice neither says that the loss shall lie where it falls, nor yet says that the loss shall be picked up from where it happens to fall and transferred to the shoulders of the other party who would otherwise not have borne it. Either natural justice, on my understanding of it, is altogether silent on a case of this sort, or it decrees that the distribution of loss shall be equal. Equal division of loss is also economically sounder than the placing of loss on one party only, for each of the two parties may be able to bear half the loss without serious consequences when the whole loss might come close to ruining him.

The British Columbia Commission was persuaded by this argument, and proposed a system based upon restitution for what has been done, and apportionment of loss.

The British Columbia Frustrated Contracts Act put this system into the following legislative formulation:

> 5.(1) Subject to section 6, every party to a contract to which this Act applies is entitled to restitution from the other party or parties to the contract for benefits created by his performance or part performance of the contract.

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60 Law Reform (Frustrated Contracts) Act, 1943 (1944), at 35-36. And see British Columbia Report, at 32.

(2) Every party to a contract to which this Act applies is relieved from fulfilling obligations under the contract that were required to be performed prior to the frustration or avoidance but were not performed, except in so far as some other party to the contract has become entitled to damages for consequential loss as a result of the failure to fulfil those obligations.

(3) Where the circumstances giving rise to the frustration or avoidance cause a total or partial loss in value of a benefit to a party required to make restitution under subsection (1), that loss shall be apportioned equally between the party required to make restitution and the party to whom the restitution is required to be made.

(4) In this section a "benefit" means something done in the fulfilment of contractual obligations, whether or not the person for whose benefit it was done received the benefit.

In response to its working paper, the British Columbia Commission received a submission which argued that there should be an exception to this system when there is an understanding that the risk of loss should be borne by one of the parties to the contract.[61] The point was made that in certain cases the business practice and commercial understanding is that of payment by results, and that the performer should bear the risk of loss up until completion of performance. This was accepted by the British Columbia Commission, and led to the enactment of the following provision in the British Columbia Act:

6.(1) A person who has performed or partly performed a contractual obligation is not entitled to restitution under section 5 in respect of a loss in value, caused by the circumstances giving rise to the frustration or avoidance, of a benefit within the meaning of section 5, if there is

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[61] British Columbia Report, at 32-33.

(a) a course of dealing between the parties to the contract;
(b) a custom or a common understanding in the trade, business or profession of the party so performing; or
(c) an implied term of the contract,

to the effect that the party performing should bear the risk of the loss in value.

(2) The fact that the party performing the obligation has in respect of previous similar contacts between the parties effected insurance against the kind of event that caused the loss in value is evidence of a course of dealing under subsection (1).

(3) The fact that persons in the same trade, business, or profession as the party performing the obligations, on entering into similar contracts, generally effect insurance against the kind of event that caused the loss in value is evidence of a custom or common understanding under subsection (1).

4. Analysis of the British Columbia Act

There are two distinct matters upon which the British Columbia Act may be critically examined. The first is the manner in which the underlying policies have been put into legislative form. The second concerns the problem of destroyed performance.

(a) A problem in terminology

The British Columbia Act was intended to embody a philosophy of restitution of benefits and equal apportionment of lost expenses. The Commission is of the opinion that the manner in which this has been put into legislation produces some uncertainty. Subsection 5(4) of the British Columbia Act defines

"benefit" as "something done in the fulfilment of contractual obligations, whether or not the person for whose benefit it was done received the benefit". Thus, performance rather than the end product of the performance, constitutes the benefit. This definition of benefit is, however, undercut by subsection 5(3) which provides that if the circumstances giving rise to the frustration "cause a total or partial loss in value of a benefit to a party required to make restitution" that loss shall be apportioned equally between the parties.

A more direct route would be to provide for the restitution of the value of benefits that remain in the hands of each party immediately after frustration of the contract, and the equal apportionment of lost expenses. This raises a second concern with the drafting: exactly what expenses are subject to this apportionment? Can one can claim only expenditures incurred <u>in</u> performance, or can one include expenses incurred <u>for the purpose</u> of performance, such as special equipment purchased in preparation of contractual performance? Section 7(a) provides:

> 7. Where restitution is claimed for the performance or part performance of an obligation under the contract other than an obligation to pay money,
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> (a) in so far as the claim is based on expenditures incurred in performing the contract, the amount recoverable shall include only reasonable expenditures;

Subsection 5(3) provides for the apportionment of the loss where there is a total or partial loss in the value of a benefit. A "benefit" is defined as something done in the fulfilment of contractual obligations. Both these provisions point to a more restrictive view of the recovery of expenses[62] - a result which may not have been intended by the British Columbia Commission. For reasons that will be discussed later in greater detail,[63] the Commission is of the opinion that expenditures should be defined as the reasonable expenses incurred in the performance of the contract or in necessary preparation for performance of the contract.

(b) The problem of destroyed performance

In both Appleby v. Myers[64] and in Parsons Bros. Ltd. v. Shea[65] a contractor had partly performed a contract for work and services when the building on which the services were rendered was destroyed by fire. The result under the English and old Uniform Act was no different than under the common law: the

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62 It should be noted that the New South Wales Law Reform Commission, supra, footnote 48, at 71 and the Law Reform Committee of South Australia, supra, footnote 50, at 15, come to differing views as to the interpretation of the British Columbia provision.

63 Infra, at 44-46.

64 (1867), L.R. 2 C.P. 651, [1861-73] All E.R. Rep. 452.

65 (1965), 53 D.L.R. (2d) 86 (Nfld. S.C.).

contractor was denied any recovery of his losses. The British Columbia Act produces a different result. Under section 5(3) the loss would be apportioned equally between the parties.

The British Columbia Commission relied upon a quotation of Glanville Williams,[66] who argued that lost expenditures would be apportioned equally between the parties to a frustrated contract. The British Columbia Commission took this to mean that there should be an apportionment whenever "the person for whom the performance was done will have nothing to show for it (e.g., work was destroyed by fire)".[67] However, Glanville Williams had in mind the Fibrosa case when he proposed that lost expenditures be apportioned equally between the parties. In that case, performance of the contract had been made illegal by the outbreak of war. The English manufacturers had done considerable work on the machinery. Nevertheless, they had to return the pre-payment made by the Polish buyers and were unable to recover anything for their lost expenditures. Glanville Williams thought this an entirely different situation than a case such as Appleby v. Myers where frustration destroys the part-performance. In such a case, he thought there should be full recovery awarded for the work done.[68] This view is shared by the New South Wales Commission:[69]

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[66] Supra, footnote 60.

[67] British Columbia Report, at 32.

[68] Law Reform (Frustrated Contracts) Act, 1943 (1944), at 48-49.

[69] Report on Frustrated Contracts (1976), L.R.C. 25, at 77.

> We give another illustration. An electrician agrees to rewire a house. He has done only some of the rewiring when the house is destroyed by fire and the contract is thus frustrated. The rewiring, so far as done, is destroyed. Surely what he should be paid for the rewiring, so far as done, should not be reduced because of the effect of the fire.

The American commentators would also allow full recovery for the part-performance, but since American law did not recognize the possibility of apportionment, the choice is which of the parties should bear the full loss.

A British Columbia court would be unable to redress this situation by invoking section 6. This section permits the court to find an implied term or common understanding in the trade that the performing party assumed the risk of the event. But in Appleby v. Myers it was the non-performing party - the property owner - who may have assumed the risk.

Professor Mullan advocates the extension of the provision to the non-performing party. He is also critical of the singling out of the insurance coverage as a special factor in finding an implied term or understanding under section 6:[70]

> Basically, it is my view on this point that while in some instances insurance may provide some evidence of an understanding that the insured is undertaking to bear the risk of frustration, this is but one of many factors that might lead to that conclusion and, because its probative value is of such marginal utility, there is no need to isolate it out for special treatment in a section of this kind. I would, however, retain the basic "risk" provision though extended to include payers of money as well as those obliged to tender a different kind of performance and making preliminary expenditures to enable that performance.

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[70] Supra, footnote 47, at 20-21.

5. The New South Wales Act

The New South Wales Commission was influenced by the British Columbia Report. The Act that it proposed adopted a basic scheme of recovery of received performance and equal apportionment of expenses. This Commission has benefitted from the work of the New South Wales Commission, and has been persuaded by many of the points made in the New South Wales Report. This Commission does not, however, propose that the New South Wales Act be used as a model. The system of adjustments in Part III of the Act "are complicated and may be open to varying interpretations, particularly if accountant expert witnesses were called in aid".[71] And after this detailed calculation is completed, the court is empowered to ignore it if it "would be excessively difficult or expensive".[72] This Commission prefers a more flexible approach in which the court is given certain principles to guide it, rather than a mathematical formula to complete.

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[71] Cheshire & Fifoot, Law of Contracts (4th Aust.Ed. J.G. Starke, P.F.P. Higgins ed. 1981), at 631. See also the comments of the Law Reform Committee of South Australia, supra, footnote 50, at 12-14.

[72] Section 15.

V. THE PROPOSED SCHEME

The British Columbia Frustrated Contracts Act introduced an important innovation by legislating the equal apportionment of reliance expenses. This Commission believes that the British Columbia Act is a welcome improvement to the remedial law, but is of the view that the notion of apportioning expenses should be developed more fully.

1. A review of the theories

Several theories for the application of remedial law following the frustration of a contract can be found in the legal literature. The first is the pure doctrinal restitutionary approach.[73] The law is concerned only with the prevention of unjust enrichment. A party may recover any benefit conferred upon the other party. Benefit in this context is given a wide meaning, as it encompasses the part-performance by another, even if that performance does not increase the recipient's wealth. Reliance expenses are not recoverable, since it is thought that it is fairer to let the loss lie where it falls.

The economic analysis of Posner and Rosenfield[74] takes them to a different conclusion. They start from the premise that the essence of the law of frustration is the determination of which

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[73] Goff and Jones, supra, footnote 56, at 564-65.

[74] "Impossibility and Related Doctrines in Contract Law: An Economic Analysis" (1977), 6 J. of Legal Studies 83.

party should bear the risk of the event. Discharge should be allowed where the promisee is the superior risk-bearer; if the promisor is the superior risk-bearer, non-performance should be treated as a breach of contract. In determining who is the superior risk-bearer, two matters must be considered: which party is in the better position to prevent the risk materializing, and which party is in a better position to insure against the risk.

Posner and Rosenfield advocate recovery only of the benefit actually received by a party prior to the frustrating event (performance itself is not considered a benefit). An apportionment of reliance losses is criticized on the basis that it results "from a misplaced emphasis on ex post loss distribution rather than ex ante risk bearing".[75] The refusal to apportion is thought to create an incentive for the superior risk bearer to adopt risk-avoidance measures.

Professor Reiter takes issue with this analysis. He makes the following argument:[76]

> In the end it involves asserting that the case is not a frustration case at all, but rather is a case of implicit allocation of risk. Instead, I suggest that in true frustration cases, the appropriate legal response is that the loss...should be split equally between the parties.

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[75] Ibid., at 113.

[76] "Real Estate - Agreement of Purchase and Sale - Down-Zoning Before Closing: How Frustrating?" (1978), 56 Can. Bar Rev. 98, at 113.

and

> The loss should normally be shared fifty-fifty. The cost of detailed judicial scrutiny outweigh the benefits of minimal flexibility, while in any case in which a dramatic departure from equal loss-sharing seems appropriate, the court should almost surely hold that the risk has been allocated implicitly by the parties.

This clearly would support the principles behind the British Columbia legislation. The scheme advocated by Glanville Williams is a hybrid. It adopts the view of performance as a benefit, but would allow equal apportionment of lost expenses other than those incurred in performing the contract.

The Commission is of the opinion that a purely restitutionary approach is too inflexible a response. A determination whether work was "in performance of the contract" or "in preparation for performance" becomes all important. This is often not an easy matter to determine. The underlying assumption is that he who requests performance must take the risk of loss owing to a frustrating event. This is too great a generalization. Suppose that a shoemaker agrees to make up a pair of shoes from leather supplied by his customer, but the shoemaker dies after half of the contract is performed, and the contract is frustrated. Surely the customer should not have to bear the risk of loss resulting from the other party's death. This Commission favours a scheme which would permit recovery of an actual benefit obtained by the other party, and further permit the court to apportion reliance losses. This will permit the court to find

that neither party is in breach of contract, yet permit recovery of expenses where one party bears primary responsibility for the situation.[77] But it does not believe that it should require that reliance losses be apportioned equally in all cases. A rule of equal apportionment of reliance losses should operate as a residual rule.

In determining whether a contract is frustrated, the court is engaged in an exercise in loss-allocation. In the first instance it decides whether it is reasonable to place the risk of non-performance on one party or the other, or neither. If it places the risk on one of the parties, that party will be bound to perform or to pay damages for breach of contract. In making this determination the court must have regard to the whole context of the contract: "by examining the contract, the inferences that can be drawn from it, the parties' expectations and knowledge, the business background of the transaction".[78] If neither party is taken to have accepted the risk, then the contract is frustrated. The reluctance of the courts to invoke the doctrine of frustration may well reflect an underlying belief that the performer is generally in the better position to assess

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[77] See Palmer, Law of Restitution (1978), Vol. II, at 131-33. In the United States, where a pure restitutionary approach is generally accepted, some courts have sought to condition the defendant's discharge from the contract upon payment of the other party's expenses.

[78] J. Swan, "The Allocation of Risk in the Analysis of Mistake and Frustration", Studies in Contract Law (J. Swan & B. Reiter ed. 1980), 181, at 211.

the risk of non-performance.[79] Frustration discharges the parties' future obligations. It does not follow that upon finding the contract frustrated, the court must ignore the contractual context and treat it as a joint enterprise. The court should have the option of placing the reliance loss on one party or the other, or apportioning it between the parties. If both parties have incurred lost expenses, the court may, in appropriate cases, hold that each is to bear responsibility for his own lost expenses.

Take as an example the following scenario. A manufacturer contracts to build machinery according to the buyer's specifications. These specifications call for a certain component available from a single source. The machinery is half completed when it becomes impossible to obtain the component from that source. A court may well conclude that neither the manufacturer nor the buyer undertook the risk of that event. Nevertheless, it may conclude that the buyer should fully bear the expenses incurred by the manufacturer, since it was the buyer who called for that particular design. If, however, the engineers of the buyer and manufacturer jointly designed the machinery, an apportionment of the losses may well be the most appropriate remedy.

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[79] Posner & Rosenfield, supra, footnote 74, at 111.

Fuller and Perdue offer another example:[80]

> Particularly in one situation, an award of damages measured by the reliance interest would seem to furnish, in the run of cases, the most equitable compromise of the interests involved; that is, where an employer, by selling or discontinuing a part or all of his business, renders impossible further performance of a contract with an employee. To grant the employee in this situation the full expectation interest may seem to restrict unduly the employer's freedom in dealing with the exigencies of business. On the other hand, to leave the employee without remedy seems unduly harsh where he has incurred expenses (for example, in moving his residence) in reliance on the reasonable assumption that his employment would endure for the whole period of the contract.

The Commission would be inclined to view such self-induced impossibility as breach of the contract rather than frustration of it. Nevertheless, where the contract is frustrated for other reasons, recompense for the employee's expenses may best accord with the underlying or implicit assumptions of the contract. In doubtful cases, the court should treat the contract as a joint undertaking and apportion the reliance loss equally between the parties.

The Commission therefore proposes the adoption of a remedial system under which unfulfilled obligations are discharged, recovery is permitted for benefits actually received by the other party, and lost expenses may be apportioned between the parties

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80 "The Reliance Interest in Contract Damages" (1936), 46 Yale L.J. 52, at 383.

equally or in such other proportion as the court thinks appropriate. The implications of such a system will now be examined more closely.

2. Discharge of obligations

The common law doctrine of frustration automatically discharges both parties to the contract from the obligation of future performance. Obligations accruing prior to the frustrating event remained unaffected, and under the English law of restitution such accrued obligations could be discharged only where the claim was for money and there had been a total failure of consideration.

Frustrated contracts legislation generally provides for the discharge of all unfulfilled obligations prior to the frustrating event, and then proceeds to apply its rules to benefits conferred and expenses incurred by the parties to the contract. The British Columbia Report recommended an exception to this rule of discharge of prior unfulfilled obligations:[81]

> A party should remain liable for damages for consequential loss. For example, if a party failed to pay a sum as required by the contract, before frustration occurred, he should be relieved from paying that sum but should remain responsible for the loss his breach may have caused, i.e., the party to whom the sum was payable may have had to borrow funds as a result and have thus incurred interest charges.

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[81] British Columbia Report, at 33.

This recommendation was implemented by section 5(2) of the British Columbia Act which provides:

> 5(2) Every party to a contract to which this Act applies is relieved from fulfilling obligations under the contract that were required to be performed prior to the frustration or avoidance but were not performed, except in so far as some other party to the contract has become entitled to damages for consequential loss as a result of the failure to fulfil those obligations.

The Commission proposes that a similar provision be adopted.

A party to a contract may be unaware of the occurrence of the frustrating event and continue rendering performance under it. A party may do so either because he was not aware of the frustrating event, or knew of the event but did not appreciate that it was a frustrating event. Neither the common law nor most of the frustrated contracts legislation apply to any performance rendered after the contract has been discharged. Recovery in such a case will depend upon the doctrine of mistake.

The Commission thinks that this bifurcation is undesirable. The remedial scheme should apply to performance rendered and expenses incurred after the frustrating event by a party on the mistaken assumption that the contract was not frustrated. The flexible nature of the proposed scheme will permit a court to deny recovery of expenses if a party is found to have been careless in failing to appreciate that the contract was

frustrated. It should be noted that the New South Wales Frustrated Contracts Act extends its scope to encompass things done after the frustrating event.[82]

3. Measuring the benefit

The next step after discharging the parties from their contractual obligations is to measure the value of the benefit conferred upon the other party to the contract. Where the only performance rendered is the payment of money the solution is simply to order the return of that money. Where property is transferred, restitution is possible by returning the property in specie promptly and without any harm to third parties.[83] Where the performance takes some other form a method must be devised for measuring the value in money terms of the benefit conferred.

Ordinarily, the law of restitution would assess a benefit on its fair market value. However, where restitution is for benefits conferred under a frustrated contract, the influence of the contract price should not be ignored. The parties themselves have set a value and this is relevant even though the contract may be at an end. As a general proposition, a party to a

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[82] Section 5(4).

[83] Section 7(b) of the British Columbia Act provides for such a return in specie of the benefit.

frustrated contract should be entitled to receive the benefit of a profitable contract and should be required to suffer the loss of an unprofitable one to the extent that it is performed.

Suppose that A contracts to sell 1,000 chairs to B for $50,000. A delivers 500 chairs to B before the contract is frustrated. The value of the benefit to B ought to be determined by pro rating the contract price. This would result in an award of $25,000. It should not matter that the fair market value of the chairs has dropped to $40 a chair (or $20,000 for the 500 chairs), or has risen to $60 a chair (or $30,000 for the 500 chairs). Palmer argues that this is entirely consistent with restitutionary principles since "it is proper to measure its value, not by a general market standard, but by the standard adopted by the parties in their contract".[84]

The British Columbia Act addresses this issue by utilizing the notion of severability. Under section 4, if part of the contract has been wholly performed except for payment of an ascertainable sum, that part can be severed and treated as a separate contract. Posner and Rosenfield comment upon a similar American divisibility rule:[85]

> The basic rationale in such cases seems restitutionary, and appears to make good sense. But it would be cleaner to drop the fiction of divisibility and simply to view the contract as discharged, and then decide what compensation is due the performing party for

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[84] Supra, footnote 77, at 126.

[85] Supra, footnote 74, at 117.

> having conferred benefits on the other party to the contract before the event giving rise to the discharge occurred.

The Commission shares this view. The scheme that it proposes permits the court to pro rate the contract price in appropriate cases without having to invoke an often fictional notion of severability.

In many cases a simple pro-rating of the contract price will not be appropriate. The contract may provide for different types of performance of differing value. In such cases the court must seek another standard such as the fair market value, the cost of the performance to the party rendering it, or the cost of completion. Even in these cases, the contract price is not irrelevant. In no case should the compensation to the part-performing party exceed the contract price.

The use of the contract price is also inappropriate where the frustrating event has reduced or destroyed the value of the performance. A shoemaker may have undertaken to produce a custom-made pair of shoes for $200. If he dies after making only one of them, it is not fair to expect the buyer to pay $100 for it. If the other shoe can be made up by another shoemaker, the contract price less the cost of completion may be the better measure. If another shoe cannot be made by another shoemaker, it would be best to find no benefit at all.

The Commission therefore proposes that in measuring the value of the benefit the court should have regard to the contract price, and should also have regard to the diminished value of performance caused by the failure to complete.

4. Measuring and apportioning the lost expenses

It will be recalled that the English Act was the first to permit apportionment of reliance expenses. This power was quite limited since a party to whom money was paid could not recover any of his expenses in excess of the prepayment. In addition, there could be no apportionment of expenses when the other party received no real advantage as a result of the part-performance. The British Columbia Act, on the other hand, calls for the automatic equal apportionment of reliance losses. This Commission proposes that a court should be empowered to order that the reliance loss be borne by one or the other party to the contract, or that it be apportioned between the parties.

It is first necessary to define what expenses are subject to such apportionment. In a celebrated article, Fuller and Perdue[86] distinguish between two types of reliance expenses. "Essential reliance expenses" are those incurred in performance of the contract or in necessary preparation for performance of the contract. These expenses are "essential" because without them the contract cannot be performed. In a contract to paint a

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[86] Supra, footnote 80, at 78 and 90-92.

house, essential reliance expenses will be the costs to the painting contractor of the work and paint actually used in performing the contract, as well as the cost of carrying the paint, ladders, scaffolding and other tools to the site.

The parties to the contract also may have incurred "incidental reliance expenses". For example the painting contractor may have turned down other painting contracts on the assumption that he will be occupied in the performance of the first one. The owner of the premises may also have incurred expenses by advertising the opening of the redecorated premises. But they are not essential because they are not necessary for the performance of the contract.

The Commission is of the view that only essential expenses should be subject to apportionment. The inclusion of incidental reliance expenses would cast the net too wide. Recovery in respect of lost opportunities would in some cases amount to apportionment of the future unperformed portion of the contract. Furthermore, incidental reliance expenses are too far removed from the contract. They are incurred because of one party's independent decision about his own affairs and it would be going too far to make the other party share in these losses.

It may be possible for the party who has incurred those expenses to apply them against some other contract. For example, if the machines partly built in the Fibrosa case could have been resold for their full cost the sellers should not be entitled to

claim them under the legislation, or if they sold them at a loss they should be entitled to claim only their net loss. This principle of mitigation of loss has been incorporated in the New South Wales Act.[87] The Commission proposes that only wasted reliance expenses be subject to apportionment.

It then becomes necessary to measure the value of the lost expenses. The Law Reform Commission of New South Wales made the following comment on this issue:[88]

> The cost incurred by a party to perform a contract may have many elements. A precise calculation of the cost of each of them may be difficult or impossible. We consider that that cost should be defined so that a fair sum for it can be ascertained without excessive investigation of each item of cost. We recommend that that cost be taken to be such amount as is fair compensation to the performing party for the burden he has incurred, acting reasonably, by paying money, doing work or doing or suffering any other thing, for the purpose of giving the performance. Precise identification, analysis and apportionment of each item of cost should not be necessary.

This Commission agrees. Furthermore, the party should be restricted to the recovery of "reasonable expenditures", a term originally adopted in the British Columbia Act.[89]

In assessing the value of lost expenses, the court should consider whether a party had entered into an unprofitable contract. The legislative scheme should not put a party to a

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87 Sections 13(2)(b) and 14(2)(b). See also the New South Wales Report, at 35, para. 7.23.

88 New South Wales Report, at 34-35, para. 7.19.

89 Section 7(a).

frustrated contract in a better position than if the contract had been performed. It should not allow a party who entered into an unprofitable contract to shift to the other party those losses attributable to his bad bargain. Suppose that a building contractor agrees to build an addition to a house for $10,000. This is a losing contract as it would cost him $40,000 to perform it. The building is destroyed by fire when half the addition has been built, and the contract is frustrated. Even if a court concludes that the homeowner should fully bear the risk of lost expenses due to destruction of the premises, it does not follow that the contractor should recover his lost expenses of $20,000, since this is in excess of the contract price had full performance been rendered. The fairer solution would be to award the contractor one-half of the contract price. Thus, having regard to the contract price, the court should assess the lost expenses at $5,000.

Next is the matter of allocating reliance expenses. The court may place the loss on one or the other of the parties, or apportion it between them. The Commission is of the view that the statute should give some guidance to the courts on this allocation. It should outline some of the factors that should be considered, but it should not purport to be an exhaustive statement.

The court must in the first instance examine the contract and the contractual background in order to see what inferences concerning the allocation of risk can be drawn from it. The court should have regard to any course of dealing between the parties to the contract, a custom or a common understanding in the trade. The court should further have regard to any general trade practice relating to insurance against the kind of event that caused the loss.

Admittedly, in many cases it will not be easy to allocate the reliance expenses. In the words of Corbin: "Where neither custom nor agreement determines the allocation of a risk, the court must exercise its equity powers and pray for the wisdom of Solomon".[90] In doubtful cases the court should simply treat the contract as a joint enterprise and apportion the expenses equally. Some commentators have speculated that in such cases it will more nearly approximate th deal the parties themselves would have made had they thought about the allocation of that risk.[91]

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[90] Corbin on Contracts (1962), vol. 6, at 371-2.

[91] Swan, supra, footnote 78, at 214; Reiter, supra, footnote 76, at 112-114.

5. Miscellaneous provisions

(a) Scope of the Act

The English and old Uniform Act did not apply to three types of contracts: voyage charter parties and the carriage of goods by sea, contracts of insurance, and certain contracts for the sale of specific goods. An absolutely convincing case has been made out against the sale of goods exception.[92] The British Columbia Act has deleted it, and this Commission does not wish to see the provision perpetuated.

Commentators are divided on whether the legislation ought to apply to insurance policies. A contract of insurance can be frustrated when the risk insured against can no longer materialize. Glanville Williams,[93] Goff and Jones,[94] and Professor Julien Payne[95] believe that there is no logical reason for excluding contracts of insurance. Gutteridge countered that "[t]he insurer has no claim to an increase of premium in case the risk should have become enhanced during the currency of the policy and the assured cannot have it both ways".[96] Treitel also

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[92] See British Columbia Report, at 35-37 for a summary of the criticisms of this exception.

[93] "The Law Reform (Frustrated Contracts) Act, 1943" (1944), 7 Mod. L. Rev. 66, at 69.

[94] Supra, footnote 56, at 582.

[95] "Reform of the Law of Frustrated Contracts in Saskatchewan" (1960), 25 Sask. Bar Rev. 94, at 97.

[96] 61 L.Q.R. 97, at 99.

supports retention of the exception.[97] The British Columbia Commission[98] was in favour of its retention for the following reasons:

1. The demands of justice are not clearly in favour of making the Act applicable to insurance contracts.
2. The sum involved is usually small.
3. Even if the exception is dropped, the insurer can contract out of the Act.
4. The matter should be dealt with in a revision of the law of insurance.
5. The exception should be retained in the interest of uniformity of insurance law across Canada.

It should also be noted that under the Saskatchewan Insurance Act[99] when a fire, hail, automobile, or sickness and accident insurance policy is voluntarily surrendered, the insurer must refund the excess of premium. This will take care of the most common types of insurance contracts. As for the rest, this Commission is, on balance, persuaded by the British Columbia Commission and proposes that the insurance exception be retained.

Finally there is the matte of charter parties and carriage of goods by sea. It is unlikely that such contracts will ever be governed by the law of Saskatchewan. Since the exception of such

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97 The Law of Contract (5th ed. 1979), at 678.

98 British Columbia Report, at 38-39.

99 R.S.S. 1978, c. S-26.

contracts reflects long established commercial practice, it is proposed that in the interests of uniformity (and out of an excess of caution) the exception be retained.

(b) Arbitration clauses

The courts have not yet resolved the question whether an arbitration clause survives the discharge of the contract, although the better view appears to be that it does.[100] Professor Mullan recommended the inclusion of an express provision to the effect that the arbitration clause survives so that it is the consensual arbitraters who will deal with disputes over the consequences of frustration.[101] The Commission agrees.

(c) Limitation of actions

The legislation should provide for a limitation period for recovery. The claim should accrue at the time of frustration or avoidance, and the limitation governing breach of contract (six years) should apply. The Commission in its Tentative Proposals for Changes in Limitations Legislation Part II: The Limitation of Actions Act[102] proposed a two year limitation period accruing when the claimant ought to have known of his claim. If this proposal is accepted, this limitation period should govern the

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[100] Payne, supra, footnote 95, at 94-95.

[101] Supra, footnote 47, at 24-25.

[102] May, 1986, at 14-19.

claim. The Commission is, however, of the opinion that the provision should be set out in the general limitations statute rather than in the frustrated contracts legislation.

(d) Conflict of laws

The English legislation provides a conflicts of law rule. The provision has been described as a "juristic blunder" by Glanville Williams,[103] and as "unnecessary and inadequate" by J.H.C. Morris.[104] The British Columbia Commission omitted the section, citing the danger of tinkering with the law of conflicts on a piecemeal basis.[105] This Commission is of the view that the development of conflicts of law rules are better left to the courts.

(e) Crown bound

Finally, the Commission proposes that the legislation provide for its binding effect on the Crown.

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103 The Law Reform (Frustrated Contracts) Act, 1943 (1944), at 19.

104 "The Choice of Law Clause in Statutes" (1946), 62 L.Q.R. 170, at 183.

105 British Columbia Report, at 41-45.

VI. SUMMARY OF PROPOSALS

1. Each party to a frustrated contract should be relieved from fulfilling obligations that were due to be performed before the frustrating event but were not performed, except that no right to damages for consequential loss which accrued prior to frustration should be affected.

2. The remedial scheme should apply to performance rendered and expenses incurred after the frustrating event by a party on the mistaken assumption that the contract was not frustrated.

3. Each party to a frustrated contract should be entitled to restitution for the performance of his contractual obligations that result in a benefit to the other party remaining after the frustrating event.

4. In measuring the benefit conferred upon another party, the court should have regard to the contract price, and should also have regard to the diminished value of performance caused by the failure to complete.

5. The court should have the power to apportion the value of reasonable expenses incurred in performance of the contract or in necessary preparation for performance if such expenses cannot be applied against some other contract.

6. In making the apportionment, the court should have regard to any course of dealing between the parties, a custom or common understanding in the trade including trade practice relating to insurance, and any other relevant circumstance that would indicate that one or the other of the parties should bear the risk of lost expenses, or that each should bear his own lost expenses. The court should also have regard to the contract price in assessing the value of lost expenses.

7. The scheme should not apply to charter parties and contracts of insurance.

8. An arbitration clause should survive the frustration of the contract.

9. The same limitation period governing actions for breach of contract should be applicable.

10. The legislation should provide for its binding effect on the Crown.

VII. THE PROPOSED ACT

Short Title

1. This Act may be cited as The Frustrated Contracts Act.

Application

2.-(1) Subject to subsection (2), this Act applies to every contract:

(a) from which the parties to it are discharged by reason of the application of the doctrine of frustration; or

(b) that is avoided under section 9 of The Sale of Goods Act;

to the extent that, upon a true construction of the contract, it contains no provision for the consequences of frustration or avoidance.

(2) This Act does not apply to:

(a) a charter party or contract for the carriage of goods by sea, except a time charter party or a charter party by demise; or

(b) a contract of insurance.

(3) This Act applies to benefits conferred and expenses incurred by a party after the frustrating event on the mistaken belief that the contract was not frustrated.

Parties relieved from accrued obligations

3. Each party to a contract to which this Act applies is relieved from fulfilling obligations under the contract that were required to be performed prior to the frustration or avoidance but were not performed, except insofar as a party to the contract has become entitled to damages for consequential loss as a result of the failure to fulfil those obligations.

Restitution of benefits

4.-(1) Each party to a contract to which this Act applies is entitled to restitution of benefits remaining after the frustrating event which are conferred by virtue of that party's performance or part performance of his contractual obligations.

(2) In measuring the value of the benefit conferred, the court shall have regard to the contract price as well as any diminished value of performance caused by the failure to complete.

(3) Where performance consists of delivery of property, the amount of the claim shall be reduced by the value of any property returned to the performer within a reasonable time.

Apportionment of lost expenses

5.-(1) In this section, "expenses" means reasonable expenses incurred in performance of the contract or in necessary preparation for performance to the extent that such expenses cannot be applied against some other contract.

(2) The court may apportion the value of lost expenses equally between the parties or in such other proportion as it thinks appropriate.

(3) In assessing the value of lost expenses, the court may have regard to the contract price.

(4) In making the apportionment, the court shall have regard to a course of dealing between the parties, a custom or common understanding in the trade including a trade practice relating to insurance, and any other relevant circumstance that indicates that one or the other of the parties should bear the risk of lost expenses, or that each party should bear his own lost expenses.

Arbitration clause survives frustration

6. A provision in a contract providing for the arbitration of disputes applies notwithstanding a frustration of the contract.

Act binds Crown

7. The Crown is bound by this Act.